

# **Report of the auditor-general to the Mpumalanga Provincial Legislature and the council on the Thembisile Hani Local Municipality**

## **Report on the audit of the financial statements**

### **Qualified opinion**

1. I have audited the financial statements of the Thembisile Hani Local Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2018, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. In my opinion, except for the effect of the matter described in the basis for qualified opinion section of my report, the financial statements present fairly, in all material respects, the financial position of the Thembisile Hani Local Municipality as at 30 June 2018, and its financial performance and cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2017 (Act No. 3 of 2017) (DoRA).

### **Basis for qualified opinion**

#### **Commitments**

3. The municipality did not have adequate systems to maintain records for commitments and assets under construction. Completed projects were included in commitments and assets under construction, which resulted in commitments and assets under construction being overstated by R46,5 million and R13,3 million, respectively. In addition, I was unable to obtain sufficient appropriate audit evidence for the amounts disclosed as assets under construction in note 3, due to a lack of supporting documents to substantiate the amounts disclosed. I could not confirm assets under construction by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to assets under construction stated at R173,3 million in note 3 to the financial statements.

#### **Context for the opinion**

4. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of this auditor's report.

5. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* (IESBA code) and the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.
6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

### **Emphasis of matters**

7. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Material impairments**

8. As disclosed in note 10 to the financial statements, the consumer debtors balance was significantly impaired. The total impairment of consumer debtors amounted to R839,2 million (2016-17: R747,2 million), which represented 95% (2016-17: 93%) of the total consumer debtors. The contribution to the provision for debt impairment was R92 million (2016-17: R179,6 million).

### **Restatement of corresponding figures**

9. As disclosed in note 38 to the financial statements, the corresponding figures for 30 June 2017 were restated as a result of an error in the financial statements of the municipality at, and for the year ended, 30 June 2018.

### **Fruitless and wasteful expenditure**

10. As disclosed in note 44 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R9,1 million, due to the overpayment of suppliers and some employees who absconded.

### **Irregular expenditure**

11. As disclosed in note 45 to the financial statements, the municipality incurred irregular expenditure of R34,9 million, as it did not adhere to the Supply Chain Management (SCM) Regulations.

### **Other matter**

12. I draw attention to the matter below. My opinion is not modified in respect of this matter.

### **Unaudited disclosure notes**

13. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA in the financial statements. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion on it.

## **Responsibilities of the accounting officer for the financial statements**

14. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the SA Standards of GRAP and the requirements of the MFMA and Dora, and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
15. In preparing the financial statements, the accounting officer is responsible for assessing the municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the appropriate governance structure either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

## **Auditor-general's responsibilities for the audit of the financial statements**

16. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
17. A further description of my responsibilities for the audit of the financial statements is included in the annexure to this auditor's report.

### **Report on the audit of the annual performance report**

#### **Introduction and scope**

18. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
19. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.

20. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected development priority presented in the annual performance report of the municipality for the year ended 30 June 2018:

Development priority	Pages in the annual performance report
KPA 1 – Basic service delivery and infrastructure development	xx – xx

21. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
22. I did not raise any material findings on the usefulness and reliability of the reported performance information for this development priority:
- KPA 1 – Basic service delivery and infrastructure development

#### **Other matters**

23. I draw attention to the matters below.

#### **Achievement of planned targets**

24. Refer to the annual performance report on pages xx to xx for information on the achievement of planned targets for the year.

#### **Adjustment of material misstatements**

25. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of KPA1 – basic service delivery and infrastructure development. As management subsequently corrected the misstatements, I did not raise any material findings on the usefulness and reliability of the reported performance information.

## Report on the audit of compliance with legislation

### Introduction and scope

26. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.
27. The material findings on compliance with specific matters in key legislation are as follows:

#### Annual financial statements

28. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of non-current assets, current assets, liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were subsequently provided, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.
29. The annual financial statements were not submitted to the auditor-general for auditing within two months after the end of the financial year, as required by section 126(1)(a) of the MFMA.

#### Expenditure management

30. Reasonable steps were not taken to prevent irregular expenditure amounting to R34,9 million, as disclosed in note 45 to the financial statements, as required by section 62(1)(d) of the MFMA. The majority of the disclosed irregular expenditure was caused by a lack of processes and mechanisms to detect and identify non-compliance with SCM Regulations. Irregular expenditure amounting to R19,6 million was incurred on key projects for a new reservoir and pipeline at Kwamhlanga for the Phola Park and Mountain View communities – phase 2 (multi-year project) and for the upgrading of existing infrastructure to augment borehole water supply in Bundu – work package 5 (multi-year project).

#### Procurement and contract management

31. Some goods and services with a transaction value below R200 000 were procured without obtaining the required price quotations, in contravention of SCM regulation 17(a) and (c).
32. Some quotations were accepted from bidders whose tax matters had not been declared by the South African Revenue Service to be in order, in contravention of SCM regulation 43.
33. Some invitations for competitive bidding were not advertised for the required minimum period, in contravention of SCM regulation 22(1) and 22(2).

34. Some goods and services with a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a).
35. Contract performance and monitoring measures and methods were not sufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.

#### **Human resource management**

36. Appropriate systems and procedures to monitor, measure and evaluate the performance of staff were not developed and adopted, as required by section 67(1)(d) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000).

#### **Consequence management**

37. Allegations of financial misconduct laid against officials of the municipality were not investigated by the disciplinary board, relevant treasury or an independent investigator or team of investigators appointed by the council, as required by municipal regulation on financial misconduct procedures and criminal proceedings 5(4).
38. In some instances, I was unable to obtain sufficient appropriate audit evidence that losses resulting from fruitless and wasteful expenditure were recovered from the liable person, as required by section 32(2) of the MFMA. This was due to proper and complete records not being maintained as evidence to support the investigations into fruitless and wasteful expenditure.

#### **Other information**

39. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report, which includes the audit committee's report. The other information does not include the financial statements, the auditor's report and the selected development priority presented in the annual performance report that has been specifically reported in this auditor's report.
40. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
41. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected development priority presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.

42. I did not receive the other information prior to the date of this auditor's report. When I do receive and read this information, and if I conclude that there is a material misstatement therein, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to retract this auditor's report and re-issue an amended report as appropriate. However, if it is corrected this will not be necessary.

#### **Internal control deficiencies**

43. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance on it. The matters reported below are limited to the significant internal control deficiencies that resulted in the qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.
44. The leadership did not adequately monitor financial reporting, reporting on performance information and compliance with laws and regulations, which resulted in material misstatements and non-compliance only being identified during the audit process. In addition, key vacancies were not filled and audit action plans were not adequately monitored to ensure the promotion of a sound control environment that supported clean financial administration and service delivery.
45. Underlying records that support the annual financial statements were not updated regularly to support the decision-making processes of the municipality. Such records include the assets under construction and commitments register, which was only compiled and updated during the audit process.

*Auditor-General*

Mbombela

30 November 2018



*Auditing to build public confidence*

## **Annexure – Auditor-general’s responsibility for the audit**

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for the selected development priority and on the municipality’s compliance with respect to the selected subject matters.

### **Financial statements**

2. In addition to my responsibility for the audit of the financial statements as described in this auditor’s report, I also:
  - identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control
  - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality’s internal control
  - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer
  - conclude on the appropriateness of the accounting officer’s use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the municipality’s ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor’s report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of this auditor’s report. However, future events or conditions may cause a municipality to cease continuing as a going concern
  - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation

### **Communication with those charged with governance**

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and, where applicable, related safeguards.